THE WORLD BANK

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LOAN COMMITTEE

LC/M/86/10

April 11, 1986

Minutes of Loan Committee to consider President's Report/Loan Agreements for the Pakistan Export Development Loan held on March 31, 1986 in Room E-1208

A. Present

Committee:	Others:
Messrs. Stern	Messrs. Cheetham
Husain	Clements
Dherse	Dubey
Hopper	El Serafy
Shihata	Gould
Mrs. Krueger	Holsen
	Krishna
	Madavo
	McCleary
	Roger
	Ms. Donovan

B. Issues

1. The meeting was called to consider the President's Report/Loan Agreement for an Export Development Loan (EDL) submitted to the Loan Committee under cover of Mr. Hopper's memorandum dated March 21, 1986. The discussion focussed on the issues raised in CPD's memorandum dated March 28, 1986 on the proposed operation.

DISTRIBUTION

COMMITTEE
Senior Vice President, Operations (Chairman)
Senior Vice President, Finance
Vice President & General Counsel
Vice President, Operations Policy
Regional Vice President concerned*
Vice President, Energy & Industry (for lending in these sectors and SALs)
Vice President, Economics and Research (for non-project lending)

OTHERS
Standard (see OMS 9.25 page 7)

*Copy to all other Regional Vice Presidents

C. Discussion

2. Macromanagement. Discussion centered upon the exchange rate and resource mobilization. The Region was asked to explain the nature of the Government's commitment on the exchange rate. The Region responded that a considerable real devaluation had taken place over the past year and the Government would commit itself to maintain a competitive exchange rate, measured not so much in terms of any target real rate but in terms of performance indicators--e.g. growth of export volumes, behavior of net foreign assets. With respect to resource mobilization and the budget, the meeting agreed that the low aggregate savings rates and weak budgetary performance was one of the most critical issues facing Pakistan and the Loan Committee asked the Region to continue exerting pressure on Government for accelerated progress in these areas. The Committee agreed with the Region that elimination of subsidies on edible oils and/or fertilizers--action on one of which was a condition of Board presentation for the EDL--would make a significant contribution to public savings and that further non-project operations would be made dependent upon Government achieving a recurrent budget surplus of 1.5% of GDP in FY1986-87 (compared to the present slightly negative level) and the initiation of a medium-term tax reform designed to broaden the tax base and increase its elasticity.

4. Export Incentives. Questions were raised whether input-output coefficients to support the standard rebate and open-bonded manufacturing system would be sufficiently robust as a basis for compensating exporters for taxes paid on their inputs and whether the system could realistically be put in place by December 1986. The Region responded that the objective was the development of the institutional capacity to making timely alterations in data needed to calculate standard rebates or allow duty-free imports under an open bonded manufacturing system; such capacity did not presently exist and the "free trade status" for exporters had been eroded. The deadline for implementation would be discussed at negotiations, but the workload for updating the standard rebate system or initiating "open-bonded manufacturing" for 70-80 existing bonded manufacturers did not seem onerous. The meeting expressed concern over the apparent complexity of establishing input-output coefficients for large numbers of firms and products and on the advisability of setting up coefficients for individual exporters. A number of suggestions were made to simplify the system by grouping like products. The meeting also asked the Region to look into the possibility of setting up a revolving fund for manufactured exports. It was noted that for an "export development loan" the loan proceeds may better be used to finance specific items needed for export development.

5. Import Liberalization. The Region stated that the appraisal mission had followed the Loan Committee's instructions to "identify possible actions and explore with Government if and when specific measures could be undertaken" in the area of import liberalization (Minutes of September 13, 1985 Loan Committee meeting). To date, Government had been

unwilling to undertake any broad trade liberalization without some ex ante analysis of the likely effects on production, employment, imports, and tax revenues, at least in the key sectors. Under the EDL, (a) the Government would commit itself to a phased, 4-5 year trade liberalization program to begin in FY1987-88 involving substantial reductions in tariffs and the number of imports subject to bans; (b) an "Industrial Efficiency Study" would support this process by designing reform programs, measuring their likely impacts, and estimating needs for financial and technical support for restructuring the key textiles, engineering, and chemicals subsectors; and (c) interim steps would be taken to eliminate or modify the effects of import bans (e.g. the elimination of bans of inputs/outputs in subsectors with export potential in the FY1986-87 Import Policy Order, and a commitment not to introduce further bans). The meeting agreed that import liberalization was crucial to efficient industrialization and export promotion, and that GOP should understand that without a clearly defined program no follow-up industrial sector loan would be possible.

6. Deregulation. The Region noted that the possible deregulation of edible oils and/or fertilizer would make a substantial contribution to resource mobilization and to industrial efficiency through the freeing up of entry, prices, and imports. While some progress had been made in relaxing investment sanctions, the size of the limits below which no sanction was required was too low and the number of cases where sanctions were required regardless of size of the investment remained too high. The meeting agreed that the dialogue with GOP should continue to stress the critical importance of relaxing entry restrictions to improved industrial efficiency, and the Deregulation Commission should be urged to tackle this issue.

7. Technical Assistance and Monitoring of Studies. In response to a question whether studies listed as special conditions (Annex III) of the proposed EDL (e.g. updating rebate rates, establishment of open-bonded manufacturing, creation of capacity for calculating input-output coefficients for manufactured exports) were already identified and supported under Technical Assistance Credit II (Cr. 1480-PAK; June 13, 1984), the Region stated that that Credit provided support for broadly defined components in various subsectors (e.g. planning, energy, industry) and that the listed studies had only been identified and terms of reference drawn up in the context of preparation for EDL. The Region also stated that within a few months Technical Assistance Credit II would be fully committed and, given the timetables for the various studies, the project should be fully disbursed by December 31, 1987. In response to a comment that the results of the PIDE study on effective protection had been disappointing both in terms of methodology and of providing practical proposals for policy reforms, the Region responded that, in order to provide adequate supervision for the studies under the proposed EDL project, staff inputs were being provided for this purpose under the Region's ESW program in addition to those being provided to supervise the EDL.

D. Conclusions

8. The Committee authorized the Region to proceed with negotiations of the proposed EDL for $70 million taking into account the guidance provided above. Should the Government take appropriate actions to deregulate both the edible oils and fertilizers subsectors prior to Board presentation, an increase in the size of the loan to $100 million would be authorized.